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April 18, 2006

AGENDA ITEM 4-B

**TO: MEMBERS OF THE BENEFITS AND PROGRAM ADMINISTRATION
COMMITTEE**

I. SUBJECT: Assembly Bill 2244 (APER&SS)—As Introduced
Disability Retirement and Technical Amendments

II. PROGRAM: Legislation

III. RECOMMENDATION: Support

This bill would correct structural deficiencies in program design related to disability retirement.

IV. ANALYSIS:

This bill would propose a clarifying amendment to the Public Employees' Retirement Law to reestablish the state of the law related to disability retirement as it was administered and applied by CalPERS for over 30 years prior to the Supreme Court's decision in *Nolan v City of Anaheim*, (2004) 33 Cal. 4th 335. This bill also contains other technical changes to the laws CalPERS administers.

Background

The Public Employees Retirement Law (PERL) provides that a member may qualify for disability retirement by establishing that he or she "is incapacitated physically or mentally from the performance of his or her duties 'in the state service.'"

Historically, CalPERS has interpreted duties "in the state service" to mean the actual duties the member was performing when he or she became disabled with his or her current employer. In September 2004, however, the California Supreme Court in *Nolan v. City of Anaheim* interpreted this section more broadly thereby establishing a new standard that CalPERS members must meet to qualify for disability retirement.

Specifically, the Supreme Court changed the criteria for determining disability retirement by interpreting "in the state service" to require a CalPERS member to show that he or she is not only substantially incapacitated from performing the usual duties of the position for his or her current employer, but also from performing the usual duties of the position for other CalPERS-covered employers. As a result, if it

is determined that a member, who is incapacitated from his or her current position, can still perform the usual duties of his or her position for another agency and that similar positions with reasonably comparable pay, benefits, and promotional opportunities are available, the member would not qualify for disability retirement. Consequently, the *Nolan* decision requires medical substantiation of the member's ability to perform the usual duties of the position in other CalPERS-covered agencies. This analysis is determined in every case because the criteria applies to all members applying for disability or industrial disability retirement.

Because of the importance of the court's decision and the need to avoid undue delay and potential litigation over the many unanswered questions in the court's decision, CalPERS supported Nolan's petition for rehearing asking the court to modify its decision and reconsider the affects of this new standard since there were many unanswered questions. However, the court denied the petition and the court's decision became final with no clarifications or other changes.

Once the decision became final on September 1, 2004, interpreting and implementing the *Nolan* decision caused temporary suspension in the processing of disability retirement because CalPERS had to change its long-standing interpretation and change its procedures to meet the new disability retirement criteria. The additional layers of review increased not only the time to process a case from beginning to end, but also the amount of staff time. All disability retirement applications are currently reviewed under the *Nolan* criteria thereby adding approximately 3.25 hours of staff-time spent processing a disability retirement application. In addition, the cost to process a disability retirement has increased by approximately \$567.27 per application. The increased cost is attributable to the additional staff time, independent medical examinations (IMEs), job assessment fees, and cost of potential litigation.

Proposed Changes

This bill would amend the PERL to reestablish the state of the law related to disability retirement as it was administered and applied by CalPERS prior to the Supreme Court's decision in *Nolan v. City of Anaheim*, (2004) 33 Cal. 4th 335. Since the *Nolan* decision interpreted the words "in the state service" more broadly, the proposed clarifying amendment would serve to reaffirm CalPERS' historical practice that a member would be eligible for disability retirement provided he or she could show substantial incapacity to perform the usual duties required of his or her current employer.

This bill also contains other technical changes to the laws CalPERS administers.

Legislative History

2005 AB 804 (La Suer) – Requires CalPERS to convert a member's industrial disability retirement allowance to a service retirement if the member is

eligible for the maximum service retirement benefit and has become employed as a peace officer outside of state service.

CalPERS' Position: Support

SB 105 (Speier) – Allows CalPERS to request medical re-evaluations for individuals over the minimum age for service retirement if they have been receiving a disability allowance for less than 36 months; current law only allows a medical re-evaluation for those under the minimum retirement age.

CalPERS' Position: Sponsor

1991 Chapter 1159 (AB 2168, Gotch) – Required that in the event of a dispute involving the issue of a local safety member's eligibility for disability retirement, the hearing shall be conducted by an administrative law judge of the Office of Administrative Hearings. *CalPERS' Position: Neutral*

1990 Chapter 658 (AB 3060, Hughes) – Provided authority to the CalPERS Board in disability determinations for local safety members who are school safety members. The governing body of the contracting agency which employs local safety members retained their authority in disability determinations of local safety members, except in the case of school safety members.

CalPERS' Position: Sponsor

1982 Chapter 330 – Added school employer to the definition of "state service."

CalPERS' Position: Neutral

1975 Chapter 655 (AB 1636, Z'Berg) – Prescribed procedures for application for disability retirement for local safety members and disability determination by the governing body of a contracting agency local employer of the member.

CalPERS' Position: Support

1957 Chapter 2399 – Added provision of "state service," solely for purposes of qualification of *benefits and retirement allowances* under this system, to include service rendered as an officer or employee of a county if the salary for the services constitutes compensation earnable by a member of this system. *CalPERS' Position: Unknown*

1953 Chapter 1186 - Added provision that member may not retire for disability if the member is qualified to be retired for service and applies prior to the effective date of his retirement for disability or within 30 days in which event the Board shall retire the member for service. *CalPERS' Position: Unknown*

1945 Chapter 123 – Added definition of "state service" to mean service rendered as an employee or officer (employed, appointed or elected) of the state, the university or a contracting agency, for compensation, and only while receiving compensation from the state, the university or the contracting agency. *CalPERS' Position: Unknown*

Issues

1. Arguments in Support

Supporters of AB 2244 state this will serve to affirm the intent that CalPERS members in state service are considered incapacitated physically or mentally for the performance of his or her actual duties with that employer. The proponents argue that this simple clarification will eliminate the increased fiscal costs attributable to *Nolan* that is ultimately passed on to the employer by way of higher employer contribution rates.

Organizations in Support: Sacramento Metropolitan Fire District; California Professional Firefighters

2. Arguments in Opposition

There is currently no known opposition at this time.

3. The Clarifying Amendment Would Serve to Re-establish the Long-standing State of the Law as Administered by CalPERS

The proposed clarifying amendment would reestablish the state of the law related to disability retirement that was administered and applied for more than 30 years prior to the Supreme Court's decision in *Nolan*. This would also be consistent with the rationale set forth in the amicus brief that CalPERS filed in *Nolan*.

4. Returning to the pre-*Nolan* Criteria Would Reduce the Current Staff Time and Cost to Process Disability Retirement Applications

CalPERS staff has determined that there have not been any disability retirement applications with a different outcome as a result of applying the *Nolan* criteria, yet the *Nolan* decision has increased the administrative costs for processing every application received by CalPERS. By returning to the previous long-standing statute and process, the current staff time may be reduced by approximately 40 percent and the administrative costs for determining disability retirement may also be reduced. The complexity of the Independent Medical Examinations may also be reduced since the doctors will not be required to address the *Nolan* criteria during, or in some cases after, the examination has been completed.

5. After Applying the *Nolan* Criteria to Disability Retirement Applications for Over a Year, There Has Not Been a Difference in Outcome Based on the *Nolan* Criteria

CalPERS completed processing of approximately 2200 disability retirement applications from December 1, 2004 through February 28, 2006. Of the 2200

applications, there have not been any disability retirement applications with a different outcome as a result of applying the *Nolan* criteria.

6. Legislative Policy Standards

The Board has historically supported legislation to correct structural deficiencies in program design. The Board's Legislative Policy Standards call for support of proposals that attempt to correct a deficiency in program design.

V. STRATEGIC PLAN:

This item is not a specific product of the Annual or Strategic Plans, but is a part of the regular and ongoing workload of the Office of Governmental Affairs.

VI. RESULTS/COSTS:

This legislation will reduce the program and administrative costs associated with processing disability retirement applications. In addition, the administrative costs for employing agencies may also be reduced.

Program Costs

The proposed legislation would reduce program costs for processing disability retirement applications using the *Nolan* criteria. CalPERS staff estimates that the current cost to process a disability retirement under the *Nolan* criteria is approximately \$1,085.92 per application as compared to the pre-Nolan cost per application of approximately \$521.65.¹ By re-establishing the state of the law related to disability retirement prior to *Nolan* the cost to process a disability retirement would be reduced by approximately \$564.27 per application.

Pre-Nolan Costs for Fiscal Year 2003/2004

Personal Services	\$1,469,869.61
Independent Medical Expenses	<u>687,167.94</u>
Total	\$2,157,037.35

\$2,157,037.35 Total Annual Cost / 4135 disability determinations = \$521.65 per application

¹ This is a simplified 'per application' estimated comparison for pre- and post-Nolan periods; comparing Fiscal Year 2003-04 with Calendar Year 2005.

Post-Nolan Costs for Calendar Year 2005

Personal Services	\$2,220,559.24
Independent Medical Expenses	<u>251,000.00</u>
Total	\$2,471,559.24

\$2,471,559.24 Total Annual Cost / 2276 disability determinations = \$1,085.92 per application

Post-Nolan Cost per Application	\$1,085.92
Pre-Nolan Cost per Application	<u>521.65</u>
Total Increased Cost per Application	\$ 564.27

Note: For the 2005 post-Nolan period, staffing expenses are slightly over-reported because of training needs. However, IME costs are under-reported because invoices for all IMEs conducted during 2005 have not been received due to the lag time. Finally, legal costs (e.g., appeal and litigation) are not factored into this analysis. It is reasonable to anticipate additional post-Nolan costs associated with legal fees.

Administrative Costs

Procedures, letters and certain publications (along with the CalPERS website) would need to be updated. If out-of-cycle publication revisions are required or contract analysts are needed to accomplish system modifications, administrative costs could be temporarily increased. Any such temporary increase, however, would be significantly less than the savings attributable to the reduction in cost and time to process a disability retirement application.

In addition, returning to the pre-*Nolan* criteria may also reduce employers' administrative costs by eliminating the additional steps that employers must currently take to comply with *Nolan*. These steps include evaluating usual and customary duties for every position in response to requests from other agencies throughout the state and who are seeking to approve or disapprove disability retirement applications for their agency.

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